

BEFORE THE  
WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

ORDER NO. 369

IN THE MATTER OF:

Served June 22, 1964

Application of Alexandria,           )  
Barcroft and Washington           )  
Transit Company for Authority       )  
to Increase Fares.                   )

Application No. 263

Docket No. 55

APPEARANCES:

S. HARRISON KAHN, Attorney for Alexandria, Barcroft  
and Washington Transit Company, Applicant.

PETER J. KOSTICK, Attorney for Arlington County Board,  
Arlington, Virginia, Intervenor.

GORDON PHILLIPS and JOHN R. SIMS, JR., Attorneys for  
D. C. Transit System, Inc., Intervenor.

RUSSELL W. CUNNINGHAM, General Counsel, Washington  
Metropolitan Area Transit Commission.

This matter came before the Commission upon the application of Alexandria, Barcroft and Washington Transit Company (A. B. & W.), for authority to increase each of its interstate fares (including interline fares) between Washington, D. C., and Northern Virginia by five cents, except children's fares in certain zones, effective April 27, 1964. The proposed fares were suspended until July 25, 1964, by Commission Order No. 354, dated April 14, 1964, pending a hearing before the Commission, pursuant to Section 6(a), Article XII, of the Washington Metropolitan Area Transit Regulation Compact, as revised March 29, 1963.

Applicant also has filed an application with the Virginia State Corporation Commission for a five cent increase in each of its Virginia intrastate fares except children's fares in certain zones, and that Commission has the matter under consideration at the present time. For the base year, January 1, 1963, to December 31, 1963, A. B. & W.'s revenues from Virginia intrastate passengers

were thirty percent of its total revenues realized from its regular route passenger service. The evidence of record in this case includes revenue projections from both interstate and intrastate operations. In determining total revenue projections for the future rate year it was necessary to take into consideration the decision of the Virginia State Corporation Commission in connection with the application before it. In order to give proper consideration to this matter, this decision is being rendered concurrently with the decision of that Commission.

Pursuant to notice duly given in accordance with the Commission's rules and regulations, public hearings were held on May 15 and on May 28, 1964. Letters in response to the application were received from eleven individuals and one citizens' association, and lodged in the file. After the hearing started, four more informal communications were received from individuals. Intervenor Arlington County Board presented testimony and exhibits through Charles E. Hammond, Executive Assistant to the Arlington County Public Utilities Commission. Intervenor D. C. Transit System, Inc., presented for the record a four-page Statement of Position concerning A. B. & W.'s request for an increase in interline fares.

A. B. & W. presented its case through Robert T. Mitchell, Executive Vice President and General Manager, Richard F. Lawson, Operations Manager, and George R. Snyder, C.P.A., representing the Applicant's independent auditors. The Staff of the Washington Metropolitan Area Transit Commission presented testimony through its Chief Engineer, Charles W. Overhouse, and its Chief Accountant, Melvin E. Lewis.

The combined testimony of these witnesses produced a record containing 288 pages of oral testimony and 29 exhibits. At the conclusion of the hearing, parties of record were given an opportunity to file memoranda in support of their position. A memorandum was filed by Intervenor County Board of Arlington County and a reply memorandum by Applicant. On the basis of all the testimony, exhibits and memoranda, the Commission is satisfied that it has sufficient data upon which to arrive at a proper decision in this case.

Determination of Net Operating Revenue, Operating Ratio, and  
Percentage of Net Operating Revenue to Gross Operating  
Revenue - for the Base Year -  
January 1 to December 31, 1963

There was no disagreement as to the book revenues and operating expenses of the Applicant for the Base Year, as adjusted after audit by the Commission Staff. However, in setting up a provision for income taxes, three major issues arose, and each of them has an important effect on the determination of Net Operating Revenue in the Rate Year. These issues are:

1. Shall Income Taxes be charged on the flow-through basis or the normalization basis?
2. Shall Income Taxes charged as an operating expense be calculated without benefit of interest expense deductions?
3. Shall Investment Tax Credits flow through to the ratepayer?

Flow-through vs. Normalization

These two basic approaches to the recording of tax liability differ from each other in the timing of the charge to the ratepayer for such tax liability. The State and Federal income tax rules are such that some deductions, such as depreciation expense, may be accelerated or charged off faster than ordinarily in the early years of the depreciable asset's use. This gives rise to a tax saving, and under the flow-through method, such saving flows through immediately to the ratepayer, only the actual current tax being charged to operating costs for the period. Under the normalization method, however, recognition is given to the fact that the acceleration of charges in the current year merely defers the incidence of the full tax to the middle and latter years of the asset's life; in anticipation of higher taxes in the future, the full tax liability (based on no acceleration of charges), is charged to operating costs immediately. The difference between the (normalized) tax thus charged and the actual tax currently payable is kept in a reserve for deferred taxes.

The Commission is of the opinion that the public interest is protected under either of these methods as long as the carrier, under normalization, sets up and maintains a Reserve for Deferred Taxes to permanently record the relationship between income taxes actually paid and normalized income taxes charged, and as long as such Reserve is kept in proper adjustment; thus, should deferred taxes be changed in amount due to changes in tax legislation, such change must be reflected in the Reserve for Deferred Taxes and passed on directly to the ratepayers. Under this procedure, the incidence of income taxes upon the ratepayer is the same in amount under either method -- the only difference being in the timing of such incidence. The Commission finds that the timing of the tax charge, indeed the basic determination as to how to file its tax return (whether to use straight-line depreciation or accelerated depreciation, for example), is within the discretion of management. This carrier opts the normalization method; as long as it carries out its accounting correctly so that the public is protected, the Commission will not interfere.

#### Interest Expense as a Deduction

The Commission can only conclude that consistent regulatory practice requires the deduction of interest expense in arriving at the income tax charged to the ratepayers. In setting the return allowed the carrier, the Commission gives full allowance to the total interest cost of the carrier; if any tax credits are generated by such cost, it would not be equitable to ignore such credits. The only other alternative would be to provide for a return to the carrier based only on the net, after-tax, cost of interest. To the extent, then, that the Commission allows the full interest obligation in setting the fair return, such interest must be used in calculating the income taxes chargeable to the ratepayers.

#### The Investment Credit

This matter fell within the general philosophy involved in flow-through vs. normalization until the enactment of the 1964 Revenue Act on February 26, 1964. Section 203(e) of that Act, Public Law 88-272, reads as follows (emphasis supplied):

"It was the intent of Congress in providing an investment credit under Section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by Section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer use --

(1) in the case of public utility property (as defined in Section 46(c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by Section 38 of such Code, or

(2) in the case of any other property, any credit against tax allowed by Section 38 of such Code,

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method."

The Commission is of the opinion that the intent of Congress should be observed.

The Commission, based on the above reasoned findings, concludes that the results for the Base Year were:

Gross Operating Revenue		\$4,704,283
Operating Revenue Deductions	\$4,576,789	
Income Taxes	<u>26,828</u>	
		<u>4,603,617</u>
Net Operating Revenue		\$ 100,666
Operating Ratio		97.86%
Percentage of Net Operating Revenue to Gross Operating Revenue		2.14%

Determination of Net Operating Revenue, Operating Ratio,  
and Percentage of Net Operating Revenue  
to Gross Operating Revenue - For the  
Rate Year, June 1, 1964 to  
May 31, 1965 - With  
No Change in Fares

The Applicant, the Intervenor Arlington County Board, and the Staff, all presented exhibits forecasting results of operations for the twelve-month period ending May 31, 1965, assuming no change in fares. The points of difference among these exhibits involved the amounts to be projected for passenger revenue, charter revenue, and wage increases. These issues can best be decided below, in discussing the projections for the same rate year with fare adjustments, because each of the submitted exhibits showed an excess of operating costs over operating revenues if there were to be no fare adjustments. These projected operating deficits ranged from \$72,129 on Staff Exhibit No. 24 to a deficit of \$117,695 on Intervenor's Exhibit No. 27.

Determination of Net Operating Revenue, Operating Ratio  
and Percentage of Net Operating Revenue to Gross  
Operating Revenue - For the Rate Year  
June 1, 1964 to May 31, 1965  
With Fare Adjustment as  
Set Forth in the Application.

Applicant's Exhibit No. 20 showed a Net Operating Revenue of \$312,950; Staff Exhibit No. 25 developed the amount of \$368,675; and Intervenor's Exhibit No. 27 (page 2) indicated an excess of revenues over expenses of \$467,993. The differences among these exhibits are due to the use of different estimates in projecting passenger revenue and charter revenue; also to the calculations used in arriving at the amounts of wage increases, insurance premiums for personal liability and property damage coverage, and income taxes. These items will be discussed in the order in which they normally appear on an operating statement, as follows:

1. Regular Route Passenger Revenue
2. Charter Revenue
3. Wage Increases
4. Insurance Premiums
5. Income Taxes

### Regular Route Passenger Revenue

Basic to the determination of this major figure is the estimate of passengers utilizing the regular route service of Applicant. Applicant conducted passenger counts on twenty weekdays, nine Sundays and nine Saturdays during October, November, and December, 1963, in order to get a current picture of the riding patterns of Applicant's lines, viz., number of passengers riding in each of the eight zones, and the number using cash fares, token fares, schoolfares, interline fares, and children's fares. These counts enabled the Applicant and the Staff to develop the percentage of passenger revenue generated in each zone by each class of fare-paying passengers. The \$4,325,623 received by A. B. & W. in 1963, spread among the various zones and fares according to the passenger counts then, showed a total of 17,048,914 passengers carried by A. B. & W. in 1963 (average fare per passenger: 25.37¢). This determination required an adjustment of the Applicant's previously reported figure of 17,405,254 for 1963. Intervenor Arlington County Board used the latter figure in some of its calculations, but the Commission deems such figure patently inaccurate, based as it is on the simple division of \$4,325,623 by an average fare of 24.85¢ which had not been revised since 1961.

Intervenor Arlington County Board attacked the accuracy of the counts, pointing to the disparity between the individual zone counts and the overall head counts. Applicant considered the overall head counts more accurate and had indeed devised such overall counts for that specific reason. Applicant's procedure was to use the zone counts for determining percentage of zone usage and then rectify the total number of passengers to the overall count, retaining the same percentage relationship between zones. The Commission's Chief Accountant, in his direct testimony, satisfied the Commission as to the statistical validity of this procedure when he explained that the figures developed by the study were related to and tied in with actual revenue going through the fare boxes. At page 176 of the Transcript, he testified:

"After determining the average daily revenue for each zone, based on each zone's riders multiplied by the fare for that zone, the total resulting calculated revenue was compared with average actual revenues. For the week day study, which covered 20 days, the daily revenue calculated was \$15,854, which compared to average actual collections for those days of \$15,772.

For the Sundays studied, the daily revenue was \$2654 compared to actual of \$2598.

For the nine Saturdays, the figures were \$6217 compared to average Saturday revenues for 1963 of \$6069.

In each case, the error was a little on the high side, resulting in a few more passengers in the final figure."

Applicant and the Staff increased the 1963 passenger volume from 17,048,914 to 17,058,296 for the Rate Year with the fare increase as applied for. This gave effect to an upward trend in passenger revenue from 1962 to 1963 of 1.86%, extended forward to June 1, 1964. In lieu of any fare-increase resistance factor between June 1, 1964 and May 31, 1965, Applicant and the Staff both took the conservative approach of having such factor offset by the projected normal growth of 1.86%. This resulted in projected revenues of \$5,189,183 by the Applicant; the Staff's figure of \$5,192,036 appears to be more accurate, due to proper weighting of increases in children's fares.

Intervenor Arlington County Board differed in its calculation not only because it started with the unadjusted 1963 passenger figures of 17,405,254, but also because it developed a growth trend of 2.51%. This Intervenor's technique was to add \$108,573 (Exhibit No. 27, page 1) to 1963 revenue for the growth trend and to add \$880,677 based on a calculated increase in fare per passenger of 4.97¢ (Exhibit No. 27, page 6). It is noted that the 4.97¢ utilized in the calculation was based on Applicant's rather than Intervenor's figures, and the figures used were inaccurate. If the proper figure of \$4,422,949 were used (per Exhibit No. 22) in lieu of the erroneous figure of \$4,342,074, the result would be 4.49¢ per passenger, and the projected increase by Intervenor would be \$795,621 instead of \$880,677. The total projected revenue by Intervenor would then be less than that projected by Applicant and Staff by some \$59,000. It is to be noted that this Intervenor's approach involved ignoring any fare resistance factor.

If Applicant had used the 2.51% growth percentage suggested by the Intervenor, instead of 1.86%, the difference would have been 111,000 passengers, or 0.65%, a minor amount, particularly in dealing with passenger estimates.

Assuming the full approval of the proposed fares by both this Commission and the Virginia State Corporation Commission, the Commission concludes that the revenues projected in the amount of \$5,192,036 is reasonably accurate.



### Charter Revenue

There was a difference of \$14,750 in the projection for this item between Applicant and Intervenor. Although both parties applied a trended increase to this item, the Commission is disposed to accept Applicant's projection because charter and sightseeing revenues are more subject to management control as to level than any other item on the revenue side of the operating statement.

### Wage Increases

This item is the major component of the increased costs projected for the future period. Applicant estimated the wage increases at \$237,947, the Staff and Intervenor at lower figures. The only point at issue is the estimate of "cost of living" wage adjustments during the test year.

Applicant's estimate was \$62,068 and was admittedly inaccurate because of a 2¢ error in the cost-of-living adjustment actually made on April 13, 1964. This error amounted to \$22,393, and is reflected in the adjusted figures utilized in the Staff's calculation. Intervenor estimated an amount of \$12,137 below that of the Staff. After considering the various bases used for these estimates, all of which are, at best, conjectural, the Commission concludes that the Staff's estimate is the most reasonable under the circumstances existing and projected.

### Insurance Premiums

Intervenor Arlington County Board objected to the projection of insurance cost for the test year at the rate of \$3.98 per \$100 of revenue as projected. In past rate cases, this Commission has looked to the fact that increased fares may increase the base for calculating premiums but they do not necessarily increase the risk exposure. The testimony in this case, however, is clear that the insurance premium for the current and test years will be based on gross revenues regardless of risk, due to the optional rate contracted for by A. B. & W.'s

management; the latter, in its discretion, chose a lower flat rate in lieu of a higher rate subject to retrospective adjustment.

#### Income Taxes

This was discussed above and decision made in favor of the normalized approach, with no effect given to investment tax credits, and deducting interest expense before arriving at the tax charge.

The Commission finds, based on the above discussion and determinations, that the fares applied for, if granted by the State Corporation Commission of Virginia and this Commission, will produce the following operating results for the Test Year, June 1, 1964 to May 31, 1965:

Gross Operating Revenue		\$5,572,787
Operating Revenue Deductions	\$4,894,301	
Income Taxes	<u>303,931</u>	
		<u>5,198,232</u>
Net Operating Revenue		\$ 374,555
Operating Ratio		93.28%
Percentage of Net Operating Revenue to Gross Operating Revenue		6.72%

Before gauging the above results against what constitutes a fair return to Applicant, the Commission must consider two aspects of the proposed fare structure, as follows:

1. Change in interline fares.
2. Effect of change in rates for Interstate Zone #1.

#### Change in Interline Fares

The Commission reaffirms its decision regarding interline fares as expressed in the W.M.A. Transit Company case, Order No. 312, served September 12, 1963, as follows:

"The Commission finds, due to various Tariff Concurrences filed by and between W.M.A. Transit Company, W. V. & M. Coach Company, A. B. & W. Transit Company and D. C. Transit System, Inc.,

on November 1, 1961, setting up the 35¢ interline fare, that the Company cannot unilaterally change this fare."

It is to be noted that the interline fare of 35¢ applies only to those trips between the first interstate zone of each of the suburban bus companies and D. C. Transit System in the District of Columbia. Thus, any increased fares beyond the first interstate zone will be borne uniformly by regular-fare riders and interline riders; the interline ticket does not become activated until the first interstate zone.

Effect of Change in Rates for  
Interstate Zone #1

The Commission has carefully considered the unusual situation existing in this zone which serves the extensive complex of Federal buildings. A. B. & W.'s service here is co-extensive with that of W. V. & M. Coach Company, and a price differential in this area, in the opinion of the Commission, would be confusing to the riding public and harmful to Applicant, by alienating large numbers of affected riders, with a corresponding loss of vital revenue.

Rate Structure Proposed by  
Intervenor Arlington County Board

This Intervenor suggested that the proposed token fares be changed to a basic rate of 22-1/2¢, creating a generalized spread of 7-1/2¢ between token and cash fares. In Exhibit No. 27, page 7, Intervenor calculated the decrease in revenue resulting from the 22-1/2¢ token fare, giving no effect to the conversion of cash riders to token riders, stimulated by the 7-1/2¢ discount. This would obviously depress revenue by a substantial amount, but page 3 of the same Exhibit gives this trend no effect at all; coupled with the \$85,000 error, mentioned previously in the \$880,677 increase in revenue projected by this Intervenor, its calculations on page 3 become unrealistic. Intervenor's witness, in his testimony, estimated an additional decrease, due to riders' choice of the token discount, of \$29,250. This figure lacked substantial documentation, and no consideration or weight was given by this witness to the effect on former cash riders in each succeeding zone. For example, a 7-1/2¢ discount on a 30¢ fare would attract relatively more token users than a 7-1/2¢ discount on a 60¢ fare.

### Intervenor's Memorandum

Intervenor Arlington County Board, in a memorandum dated June 5, 1964, compares the rates presently charged by W. V. & M. Coach Company with the rates proposed by A. B. & W. for approximately similar distances. Although this Commission is aware and is advised of the relationship of rates between the various carriers in the Metropolitan District, it is the Commission's finding that each carrier has its own peculiar financial requirements and its own peculiar set of load factors, fixed costs, and variable costs. Accordingly, rates found fair and reasonable for one company cannot always be found to be fair and reasonable for another, but different company.

Intervenor commented on the possibility of holding certain portions of the requested rate increase in abeyance until some time in the near future. This Commission cannot set rates "in futuro" as any increase in fares must be based solely on the evidence of record covering projections for the test year. Furthermore, the continuous fluxuation of conditions inherent in transit operations mitigates against the prescribing of rates to become effective on an indefinite date in the future.

#### Determination of Return if Fares Are Increased as Requested Except For Interstate Zone #1 and Interline Fares

Based on the discussion and findings above, the Commission finds that if fares are increased as requested, except for Interstate Zone #1, and Interline fares, the following operating results will flow:

Gross Operating Revenue		\$5,472,134
Operating Revenue Deductions	\$4,902,432	
Income Taxes	<u>248,593</u>	
		<u>5,151,025</u>
Net Operating Revenue		\$ 321,109
Operating Ratio		94.13%
Percentage of Net Operating Revenue to Gross Operating Revenue		5.87%

#### Adequacy of Return

This Commission, bound by the Compact to use of the Operating Ratio in measuring return (Article XII, par. 6(a)(4)), must determine whether or not the return to be generated by the new schedule of fares constitutes a fair return. The term "fair return"

has a dual connotation -- it must be fair to the public and fair to the carrier.

This Commission is aware of the peculiar value of the operating-ratio approach to rate-making in the motor carrier industry, as differentiated from the rate-base and return-on-investment techniques. The latter techniques are well suited for a high-cost, long-lived investment base where fixed costs are the major financial considerations. In the motor carrier industry, however, the basic plant devoted to public use is relatively short-lived, and the strategic financial problem turns upon the current operating costs and their delicate relationship to operating revenues. This Commission must therefore consider the specific relationship between projected revenues and projected costs, and try to leave a few cents' spread between each projected dollar of revenue and projected costs. This spread represents the carrier's margin, which will have to provide the funds to (1) enable applicant to meet its interest requirements; (2) pay reasonable dividends; (3) permit retention of a reasonable amount in the business to provide for contingencies; and (4) attract the necessary funds to meet future capital needs.

The amount of \$321,109 as net operating income represents an operating ratio of 94.13%, or a return on gross operating revenue of 5.87%. Based upon the risks inherent in this industry in general, and in Applicant's specific situation, considering the relative stability of Applicant's business experience, and the other statutory requisites, this Commission finds that an operating ratio of 94.13% and return of approximately \$320,000 is fair and reasonable both to the investor and the ratepayer.

It is apparent that Intervenor Arlington County Board does not take issue with the conclusion that net earnings, after taxes, in the amount of \$321,109 for Applicant are not unreasonably high. In its Exhibit No. 27, page 3, Intervenor proposed fares which, in its opinion, using Intervenor's projections of revenues and expenses, would generate net operating income (line 2 minus line 15) of \$362,847 and an operating ratio of 93.4% (line 16) for a return of 6.6% on gross operating revenues, all substantially more liberal than the projections arrived at herein.

The Commission has been advised by the State Corporation Commission of Virginia that it has arrived at its decision on A.B. & W.'s application to increase intrastate fares. The close cooperation between this Commission and the State Corporation Commission of Virginia reflects the spirit of the Compact.

The State Corporation Commission of Virginia will not grant the increase requested in intrastate fares in A. B. & W.'s Intrastate Zone #1, the area known as the Federal Installations area.

Hence the increased fares to be authorized in this Order will generate net operating income below the \$321,109 found above, but, in the judgment of this Commission, still within the range of reasonableness of a fair return.

Upon the evidence adduced, the Commission further finds and concludes:

1. That the present fares of Applicant are unjust and unreasonable, except as noted below, and will not generate sufficient revenues to maintain Applicant in a sound financial condition, and consequently, will not enable Applicant to render adequate and satisfactory service to the public in the future.
2. That the proposed interline fare and the proposed fares between Springfield and Washington (Line 1, Zone 6), be rejected.
3. That the other fares proposed by Applicant (except those rejected above), are just and reasonable and are not unduly preferential or unduly discriminatory either between riders or sections of the Metropolitan District.
4. That the fares authorized by this Order and authorized by the Virginia State Corporation Commission will produce sufficient net earnings to allow Applicant to service its debt, pay reasonable dividends, retain a reasonable amount of earnings in its business, and will enable Applicant to render proper, adequate and satisfactory service to the public.

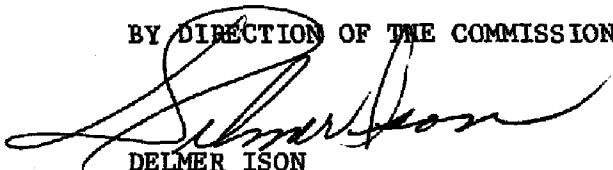
#### ORDER

THEREFORE, IT IS ORDERED THAT:

1. Effective 5:00 A.M., July 6, 1964, A. B. & W. Transit Company be, and it is hereby, authorized to establish the rates of fare as shown in Supplement No. 1 to WMATC Tariff No. 5, Supplement No. 1 to WMATC Tariff No. 2, and WMATC Tariff No. 13, except that no fares shall be increased above those presently in effect in Interstate Zone No. 1 and Zone No. 6 of Line No. 1, and the thirty-five cent (35¢) interline fare shall remain unchanged.

2. A. B. & W. Transit Company shall file with this Commission, at least ten (10) days prior to the effective date of any change in fares, appropriate Tariffs pursuant to the authority granted herein.

3. A. B. & W. Transit Company shall post in all of its buses, at least ten (10) days prior to the effective date of any change in fares, appropriate notices indicating all changes in fares pursuant to the authority granted herein.

BY  DIRECTION OF THE COMMISSION:

DELMER ISON  
Executive Director